

**TREASURY - GENERAL**

**STATE INVESTMENT COUNCIL**

**Real Assets**

**Proposed Amendments: N.J.A.C. 17:16-71.1 and 71.2**

Authorized By: State Investment Council, William G. Clark, Director,  
Division of Investment

Authority: N.J.S.A. 52:18A-91

Calendar Reference: See Summary below for explanation of exception to calendar  
requirement.

Proposal Number: PRN 2006-53

Submit written comments by April 22, 2006 to:

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The agency proposal follows:

**Summary**

The proposed amendments to N.J.A.C. 17:16-71.1 and 71.2 are intended to modify the leverage limitation applicable to investments by Common Pension Fund E in real assets, and to make other non-substantive changes to N.J.A.C. 17:16-71.

The Council is proposing to amend N.J.A.C. 17:16-71.1 to add new definitions for “core” and “non-core” real estate. The new definitions are required, because the proposed new leverage limitation in N.J.A.C. 17:16-71.2 establishes different leverage limitations for each of these two types of real estate investments.

In addition, the Council is proposing to make amendments to other definitions in N.J.A.C. 17:16-71.1. The Council is proposing non-substantive amendments to the definition of “commodity-linked investment,” and amendments to the definition of “co-investment” to clarify that co-investments may be made by investors other than a fund in

which Common Pension Fund E invests, and may be made in portfolios and properties as well as companies. The Council is also proposing to amend the definition of “commingled funds” to clarify that certain commingled funds may include investors other than institutional tax-exempt investors.

The Council is proposing to amend the definition of “direct investment” to clarify that Common Pension Fund E is not required to purchase a controlling interest in a company or venture, and is not precluded from dealing with brokers or other intermediaries when purchasing an interest in a company or venture. Similarly, the definition of “joint venture” is being amended to correct any misperception regarding the status of Common Pension Fund E as an instrumentality of the State.

The Council is proposing to amend the definitions of “East” and “Midwest” to clarify which states are in the New England region and to include an omitted state (Indiana).

The Council is proposing to amend N.J.A.C. 17:16-71.2(a)1i, so that the leverage limitations of that subparagraph would no longer apply to each investment vehicle in which the Director invests, but instead would apply to the relevant (that is, core or non-core) real estate portfolio of Common Pension Fund E. The amendment would change the leverage limitation from a one-time limit of 160 percent of equity value at the time of purchase, to an ongoing limitation of 50 percent (for core real estate) or 75 percent (for non-core real estate) of Common Pension Fund E’s share of the respective portfolio’s gross market value.

The Council is proposing to add a new subsection (b) to N.J.A.C. 17:16-71.2, which would require the Division to notify the Council of any violation of the leverage and value limitations of the section, and would permit the Council to grant a grace period for the Division to cause the real estate portfolio of Common Pension Fund E to conform with the limitations of the section.

Because the Division is providing a 60-day comment period for this notice of proposal, this notice is excepted from the rulemaking calendar requirement pursuant to N.J.A.C. 1:30-3.3(a)5.

### **Social Impact**

There will be no social impact from the proposed amendments.

### **Economic Impact**

There will be a positive impact from the proposed amendments on participants in those pension and annuity funds eligible to invest in Common Pension Fund E, by allowing the Division more flexibility in investing common fund assets in equity real estate.

### **Federal Standards Statement**

A Federal standards analysis is not required because the investment policy rules of the State Investment Council are not subject to any Federal requirements or standards.

### **Jobs Impact**

The State Investment Council and the Division of Investment do not anticipate that any jobs will be generated or lost by virtue of the proposed amendments.

### **Agriculture Industry Impact**

The proposed amendments will have no impact on the agriculture industry.

### **Regulatory Flexibility Statement**

A regulatory flexibility analysis is not required, since the proposed amendments impose no requirements on small businesses as the term is defined in the Regulatory Flexibility Act, N.J.S.A. 52:14B-16 et seq., but regulate only the Director of the Division of Investment.

### **Smart Growth Impact**

The proposed amendments are not anticipated to have an impact on the achievement of smart growth and implementation of the State Development and Redevelopment Plan.

Full text of the proposal amendments follows (additions indicated in boldface thus; deletions indicated in brackets [thus]):

## SUBCHAPTER 71. REAL ASSETS

### 17:16-71.1 Definitions

The following words and terms, as used in this subchapter, shall have the following meanings, unless the context clearly indicates otherwise:

"Co-investment" means two parties (usually the limited partner and the general partner of a fund) invest alongside each other in the same company, **portfolio or property**. If a limited partner in a fund has co-investment rights, it can invest directly in a company [that is also backed by a fund], **portfolio or property in which the fund also invests**. The institution, therefore, ends up with two separate stakes [in the company] – one indirectly through the fund; one directly in the company, **portfolio or property**. **Co-investment may also include multiple like-minded institutional investors investing in a specific company, portfolio or property.**

"Commingled funds" means all open-end and closed-end pooled investment vehicles designed **primarily** for institutional tax-exempt investors. A commingled fund may be organized as a group trust, partnership, corporation, insurance company separate account, or other multiple ownership entity.

"Commodity-linked investments" means investments [in] **from** which all or a portion of the return is linked [in] **to** the price of a particular commodity or equity security, or to an index of such prices. These include commodity-indexed deposits, loans, debt issues, and derivative products, such as forwards, options, and swaps. In these transactions, the interest, principal, or both, or payment streams in the case of swaps, are linked to the price of a commodity.

**"Core real estate" means equity investments in existing, stabilized (meaning at least 80 percent occupied), well-leased assets.**

"Direct investment" means the purchase of an interest in a company or venture [that has enough influence to direct the course of the investment. Direct investment usually avoids intermediaries between the buyer and the seller] **directly by Common Pension Fund E, rather than through an investment vehicle.**

"East" means [New England] **Maine, New Hampshire, Vermont, Massachusetts, Connecticut, Rhode Island,** New Jersey, New York, Pennsylvania, Delaware, Kentucky, Maryland, North Carolina, South Carolina, Virginia, Washington D.C. and West Virginia.

"Joint venture" means a contractual agreement joining two or more parties for the purpose of executing a particular undertaking. All parties agree to share in the profits and losses of the enterprise. [Joint ventures are usually private.]

"Midwest" means Illinois, **Indiana**, Michigan, Ohio, Wisconsin, Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota and South Dakota.

**"Non-core real estate" means equity investments in value-added or opportunistic strategies, including direct property investment with lease-up, development or redevelopment risk. Non-core real estate includes recapitalizations across capital structures and property types and access to niche markets.**

#### 17:16-71.2 Permissible investments

(a) Subject to the limitations contained in this subchapter, the Director may invest in real assets in any of the following ways:

1. Investment in real estate assets through direct investments, separate accounts, commingled funds, co-investments and joint ventures is permissible provided:

i. [Leverage within the investment vehicle is limited to a maximum of 160 percent of equity value at the time of purchase.] **The maximum consolidated principal amount of leverage within the real estate portfolio of Common Pension Fund E shall not exceed 50 percent and 75 percent of Common Pension Fund E's share of the gross market value of Common Pension Fund E's investment in core real estate and non-core real estate, respectively.**

ii. – iv. (No change.)

2. (No change.)

**(b) If the leverage or market value exceeds the limitations set forth in (a) above, then the State Investment Council shall be notified at a regularly scheduled meeting of the Council. The Division may be granted a six-month period of grace to cause the real estate portfolio of Common Pension Fund E to conform with the limitations, except that the period of grace may be extended for additional four-month periods with the approval of the Council.**